No. 15,187

IN THE

United States Court of Appeals

For the Ninth Circuit

S. B. HUFFMAN, Trustee in Bankruptcy of Charles Manfre Transportation Co., Bankrupt,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the Northern District of California, Southern Division.

APPELLANT'S REPLY BRIEF.

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ARGUMENT.

I. THE SERVICE OF A NOTICE OF LEVY UPON A DEBTOR OF THE BANKRUPT PRIOR TO THE FILING OF THE PETITION IN BANKRUPTCY DOES NOT CONSTITUTE A SEIZURE OF THE DEBT.

A. Introduction.

We agree with appellee's statement in its brief (Ans. Br. p. 6) that the intangible obligation owing to the bankrupt became subject to the federal tax lien when that obligation came into existence. That is a legal proposition far too well established to be controverted and we

do not wish to be placed in the position of appearing to deny it.

But we do quarrel with appellee's conclusion that its lien was a lien "accompanied by possession" of the obligation within the meaning of Section 67c of the Bankruptcy Act. Thus, while appellee's claim for taxes is entitled to lien status in the bankruptcy proceeding (*United States v. England* (CA 9, 1955), 226 F. 2d 205), the lien must be subordinated in payment to the classes of claims protected under Section 67c.

Appellee itself admits that it never at any time obtained actual possession of the obligation. This failure it excuses by arguing that this case involves neither "tangible physical assets which could have been seized and sold at public auction as provided by Section 3693, Internal Revenue Code 1939; nor . . . intangible property which is evidenced by some negotiable instrument which also may be made the subject of actual possession and likewise may be subjected to public sale." (Ans. Br. pp. 5-6.)

But the fact that this case deals with intangible property other than a negotiable instrument is not significant. There is nothing in this case that would have prevented appellee from selling its lien rights against the obligation had it been inclined to do so. The fact that the obligation was contested and disputed would not prevent its sale by appellee although it is true, in the words of Judge Learned Hand, that "a disputed chose in action will not bring as good a price as an undisputed one; but neither will a chattel delivered at a sale if the title is doubtful." *United States v. Metropolitan Life Insurance Co.* (CA 2, 1942), 130 F. 2d 149, 151.

Nor was there anything in this case that would have prevented appellee from attempting to collect under the obligation or from foreclosing upon the obligation by way of suit had appellee been zealous in enforcing its rights. (Op. Br., pp. 13, 43.) Consequently, appellee should be treated under Section 67c in exactly the same manner as if the rights levied upon were rights in tangible property or rights in a documentary chose in action. Certainly the statute itself makes no distinction between various types of intangible properties; nor is there any good reason to draw any such distinction so long as appellee has these alternative procedures of enforcing its lien available to it, regardless of the type of intangible property involved.

B. If the United States has failed to acquire actual possession of personal property prior to bankruptcy, its lien thereon must be subordinated under Section 67c of the Bankruptcy Act.

Despite the difference in facts, appellee argues that this case is controlled by the decision in *United States v. Eiland* (CA 4, 1955), 223 F. 2d 118. Perhaps, as appellee observes (Ans. Br. p. 7), the United States had, in the *Eiland* case, "taken all steps which were legally available to subject the debt to its possession." But certainly the same statement cannot be made about appellee's actions in the present case. Appellee attempted neither to collect under its notice of levy (Section 3710, Internal Revenue Code, 1939), nor to sell any rights to the obligation it may have acquired under its notice of levy (Section 3693, Internal Revenue Code, 1939), nor to perfect its notice of levy by instituting a suit to foreclose against the obligation (Section 3678, Internal Revenue Code, 1939). Why

these things were not done appellee fails to say. Perhaps the very contingency of the obligation, prior to appellant's action in reducing it to a sum certain, was sufficient to discourage appellee from taking any of the supplementary courses of action readily available to it. Whatever the cause, appellee chose to do nothing to enforce its rights.

Appellee asserts (Ans. Br. p. 8) that once the notice of levy was served, the bankrupt was powerless to demand payment of the obligation from Utility Trailer Sales. The facts of this very case refute appellee; it was appellant, claiming under the bankrupt, not appellee, who actually made the demand for payment that was effective to compel Utility Trailer Sales to pay. (R. 4, 11.)

Appellee cites a number of cases to show that a petition in bankruptcy does not "void a prior levy." (Ans. Br. p. 8.) None of these cases is in point. *York Mfg. Co. v. Cassell* (1906), 201 U. S. 344, 26 S. Ct. 481, dealt not with a levy under the federal tax lien, but with the effect of a *failure* to file a notice of lien by a private conditional sales vendor. *Mason v. Citizens' National Trust & Savings Bank* (CA 9, 1934), 71 F. 2d 246, also deals with a problem other than the handling of a statutory lien under Section 67c of the Bankruptcy Act. It involves the problem of deciding whether the lien of a chattel mortgage reaches after-acquired property of the bankrupt. *In re Knox-Powell-Stockton Co., Inc.* (CA 9, 1939), 100 F. 2d 979, does in fact pertain to the tax liens but in another context. The issue there was whether or not a claim for federal taxes could properly be subordinated in payment to prior tax liens of the State of California. This Court

held that the lien claims for taxes were superior to the unsecured claims for taxes filed by the United States. *Rode & Horn v. Phipps* (CA 6, 1912), 195 Fed. 414, involved the validity of a private chattel mortgage in bankruptcy when the mortgagee had previously subordinated its lien to that of another creditor.

Furthermore, none of these cases cited by appellee could possibly have decided the problem we are faced with in the present case. All of them concerned applications of the bankruptcy law as it existed prior to 1938, the year in which Section 67c was added to the Bankruptcy Act. Act of June 22, 1938, c. 575, Sec. 67; 52 Stat. L. 875 at 877. All but the *Knox-Powell-Stockton Co., Inc.,* case were decided prior to 1938, and the latter was expressly decided under the Bankruptcy Act of 1898, as amended in 1926. 100 F. 2d 979 at 981. See 4 Collier on Bankruptcy (14th ed., 1942, Matthew Bender & Co.) ¶67.02, footnotes 24, 27.

Appellee claims that unless this Court award it the fund created out of appellant's efforts, Utility Trailer Sales will be required to pay twice. This assertion disregards the record herein. In making the compromise settlement with Utility Trailer Sales herein, appellant expressly agreed to hold Utility Trailer Sales harmless for any liability appellee might assert against it outside the bankruptcy court. (R. 4-5.) There can be no double liability arising out of this controversy and appeal. Appellee's intimation that Utility Trailer Sales may be liable directly to it under the notice of levy is an attempt to introduce another law suit into the present controversy that is independent of it; furthermore, appellee itself

never chose to prosecute this extraneous claim of liability at any time prior to this appeal although appellee has not lacked opportunity to do so.[1]

C. Service of a notice of levy not accompanied by an actual seizure of property is ineffective to reduce an intangible obligation to possession.

Appellee argues that the actual seizures of property and rights to property made by the Collector in the cases of *In re Brokol Manufacturing Co.* (CA 3, 1955), 221 F. 2d 640, 641, and *In re Mutual Carrier Co., Inc.* (D. C. Conn., 1952), 52-2 USTC ¶ 9507, were immaterial (Ans. Br. pp. 9-10). If Section 67c, clause (1) spoke in terms of "levy" as well as of "possession," appellee might well be right. But so long as Section 67c demands that the United States lien for taxes be "accompanied by possession" appellee must make an actual seizure of property or rights to property in order to claim the property or rights to property free of the bankruptcy administration. That was the strict test demanded of the United States in the *Brokol* and *Mutual Carrier* cases and the same should be demanded of appellee herein.[2]

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[1]This is not to intimate that Utility Trailer Sales lacks an adequate defense to any such action on appellee's part. A notice of levy served on an unaccrued obligation which is contested by the obligor is unenforceable. *United States v. Metropolitan Life Insurance Co.*, (CA 2, 1942) 130 F. 2d 149; *United States v. Penn Mutual Life Insurance Co.*, (CA 3, 1942) 130 F. 2d 495; *United States v. Massachusetts Mutual Life Insurance Co.*, (CA 1, 1942) 127 F. 2d 880.

[2]The fact that seizure of a taxpayer's passbook may not be essential to enforce a levy on a bank account independent of bankruptcy proceedings ought not to control this case. See *United States v. Manufacturer's Trust Co.*, (CA 2, 1952) 198 F. 2d 366. In suing Manufacturer's Trust Co., the United States was not required to show that its lien was "accompanied by possession" as appellee must show in order to stand outside the subordination clause of Section 67c in a bankruptcy proceeding. Furthermore,

Nor, as appellee implies, is this an idle requirement. Actual seizure of personal property is required under Section 67c for the purpose of giving notice to innocent wage earners and creditors of appellee's claim of lien on the bankrupt's personal property. Only by publicly disturbing the bankrupt's possession can sufficient notoriety be created to meet the policy of Section 67c. Anything less than actual seizure is not enough. All that was done in the present case was to notify the bankrupt's conditional obligor of the existence of appellee's lien and to demand payment thereon. (Ans. Br. pp. 9-10.) Nothing of a public nature was done to advise the bankrupt's employees or creditors of appellee's lien. As appellee itself admits, "the service of any levy or execution upon an intangible is never a widely publicized fact. In most instances, the only parties with knowledge of such a seizure would be the person issuing the levy and the person upon whom the levy was served." (Ans. Br. p. 13.) In the absence of public notoriety and warning to its actions, appellee's claim of lien should be subordinated under the express terms of Section 67c as representing a statutory lien for taxes "unaccompanied by possession."

Appellee contends further that the public notice policy underlying Section 67c was met in the present case by the mere fact of service of the notice of levy. Appellee points out that after the service of the notice of levy, Utility Trailer Sales was itself fully advised of the existence of the federal tax lien. (Ans. Br. pp. 12-13.) But

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distraint on a bank account is expressly authorized by statute (Section 3690, Internal Revenue Code, 1939), which is not true of an indebtedness not evidenced by a writing.

such notice to the person levied upon is hardly notice to the public at large. Creditors, and more importantly wage earners, of the taxpayer would not be given warning by a procedure that called only for the service of a document on a third party. If, for example, accounts receivable were levied upon without public seizure of account books in the possession of the taxpayer, both creditors and employees would be misled by the apparent assets of the taxpayer that had not been disturbed by the government. Mere service of a notice of levy is not a widely publicized act.

Appellee attempts to surmount this obstacle to its conclusion that a notice of levy should be equated with possession by putting the burden of inquiry upon others; thus the taxpayer's employees and would-be creditors should be required to discover for themselves whether or not the taxpayer's personal properties have been levied upon by the government. It is not, as appellee asserts, a common auditing technique of employees and creditors to correspond with the taxpayer's debtors to ascertain the status of the taxpayer's accounts. (Ans. Br. p. 13.) Appellee has reference to an auditing technique commonly employed by *the taxpayer's* own accountants in order to verify its assets, not by accountants for strangers dealing with the taxpayer. Certainly appellee ought not to be permitted to prevail herein because of what third parties would or would not do. Section 67c lays the burden squarely upon appellee's own broad and formidable shoulders to reduce its lien to possession prior to bankruptcy. This appellee has failed to do. Consequently it must suffer its lien to be subordinated in the limited fashion demanded by Section 67c.

II. A SERVICE OF A NOTICE OF LEVY UPON AN UNACCRUED AND UNCERTAIN OBLIGATION IS INEFFECTIVE AND UNENFORCEABLE.

Appellee's main defense to this point made by appellant in its opening brief (Op. Br. pp. 24-29) is to argue that the findings of fact herein state that the obligation of Utility Trailer Sales at the time the levy was served was $2,309.49, the sum later paid to appellant. (Ans. Br. pp. 13-14.) While it is true that the findings of fact are stated in such terms, these findings are incorrect and are not an accurate reflection of the record herein. R. 3-4, 20.) The matter was submitted to the Referee in Bankruptcy on an agreed stipulation of facts. (R. 16-17, 20-27.) Under these circumstances, this Court is free to draw its own conclusions from the undisputed facts. *Gensinger v. Commissioner* (CA 9, 1953), 208 F. 2d 576, 583; *McGah v. Commissioner* (CA 9, 1954), 210 F. 2d 769, 771; As this Court stated in *Pacific Portland Cement Co. v. Food Machiney & Chemical Corp.* (CA 9, 1949), 178 F. 2d 541, 548, "we may make our own inferences from undisputed facts or purely documentary evidence."

Appellee asserts further that in any event a *right to property* was in existence on the date the notice of levy was served. But there can be no right to property in one person unless another is under a correlative duty to deliver the property up.[3] And this was not the fact on

[3]Furthermore, it is difficult to understand how an obligation to pay money can represent a "right to property" in view of the amendment by Congress in 1954 to add the phrase "or obligated with respect to (property or rights to property)" to the statute authorizing levies. Section 6332(a), Internal Revenue Code, 1954. This changed language was expressly called to appellee's attention in our opening brief, but no answer has been made to it (Op. Br. pp. 25-26, footnote 12).

the date the levy was served. On that date and subsequently, Utility Trailer Sales denied both the amount and the very existence of any liability to the bankrupt. It was not until the compromise settlement of appellant's turnover proceeding against Utility Trailer Sales that the obligation became fixed and certain. At that time, the amount owing was determined to be $2,309.49 and that sum was paid over *to appellant.* (R. 3-4.)

It is true, as appellee asserts, that three of the cases cited in our opening brief deal with the problem of levying upon life insurance policies. (Ans. Br. p. 14.) But this fact does not render these decisions inapplicable herein. The underlying rationale of these three decisions, each of a Court of Appeals for a different circuit, applies to this case as well as to the rights of the government under a levy upon an *unaccrued* obligation to pay over the cash surrender value of a life insurance policy to the insured. In both situations a levy is unenforceable because (1) there is nothing actually due and owing at the time the levy is served, and (2) there are alternative procedures available to the government to reach the unaccrued obligation to determine the conflicting rights of the insured, the insurer and the government.

Parenthetically we should add that it is not our position that *all* levies must be enforced by judicial proceedings. We merely point out that it is incumbent upon appellee to take steps to enforce any levies made by it that have been returned unsatisfied. If appellee does not see fit to enforce the many rights it has been given by Congress under the Internal Revenue Code, appellee ought to suffer the consequences of its inaction. It should not be treated

herein as if it had actually enforced its notice of levy when in fact it took no subsequent action. This failure to act is exactly the type of conduct Congress intended to penalize when it added Section 67c to the Bankruptcy Act. 4 Collier on Bankruptcy (14th ed., 1942, Matthew Bender & Co.), ¶67.20(3); *City of New York v. Hall* (CA 2, 1944), 139 F. 2d 935, 936.

III. THE APPLICABILITY OF APPELLANT'S AUTHORITIES TO THE CONTROVERSY HEREIN.

Appellee states that appellant's authorities are not in point because they "involve tangible property which can be subjected to physical possession, and to public sale." (Ans. Br. pp. 15-16.) This is not a true statement. *In re Milo O. Frank* (S. D. Cal., 1955), 55-2 USTC ¶ 9772, dealt with the application of Section 67c to the tax lien of the government against *stock* of the bankrupt.[4] Among the assets seized in *In re Brokol Manufacturing Co.* (CA 3, 1955), 221 F. 2d 640, were the bankrupt's *accounts receivable.* See *In re Brokol Manufacturing Co.* (D.C. N.J., 1953), 109 F. Supp. 562, 563. Again in the case of *In re Mutual Carrier Co., Inc.* (D.C. Conn., 1952), 52-2 USTC ¶ 9507, *accounts receivable* of the bankrupt were involved.

Apart from these three cases in which it affirmatively appears that intangible property was involved, there is nothing to show in the record of the remaining cases cited

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[4]As far as we can ascertain the government has not appealed the *Frank* case to this Court although the decision was against it. Subsequently another of the district courts in this Circuit refused to follow the *Eiland* case. *Northeast Clackamas C. E. Coop. v. Continental Casualty Co.,* (D.C. Ore., 1955) 140 F. Supp. 903, 905.

by appellant in its opening brief that *only* tangible property had been seized. For example, in *City of New York v. Hall* (CA 2, 1944), 139 F. 2d 935, the property attempted to be seized prior to bankruptcy was described as "personal property," which might or might not include intangible property. The same is true of *Goggin v. Division of Labor Law Enforcement* (1949), 336 U. S. 118, 122, 69 S. Ct. 469, 471, in which the government "perfected a statutory lien upon the *personal property* of the Kessco Engineering Corporation, a California corporation, and took *actual possession* of *such property* pursuant to that lien." (Emphasis added.) Inferentially, at least, the personal property of a business would include intangible as well as tangible personalty, but this fact the record does not spell out, as appellee claims. See *Division of Labor Law Enforcement v. Goggin* (CA 9, 1947), 165 F. 2d 155, 156. Nor was the seizure in *United States v. Sands* (CA 2, 1949), 174 F. 2d 384, 385, limited to tangible property; it included "the personal property of the taxpayer." The same is true of two other authorities cited in our opening brief: *Henkin v. United States* (CA 2, 1956), 229 F. 2d 895, 896 (all of the bankrupt's "assets"); and *Davis v. City of New York* (CA 2, 1941), 119 F. 2d 559, 560 (all of the bankrupt's "property").

Furthermore, there is nothing inherently impossible, as appellee intimates, in holding a public sale of an intangible obligation. Even a disputed chose in action is capable of being sold at public auction. See *United States v. Metropolitan Life Insurance Co.* (CA 2, 1942), 130 F. 2d 149 at 151. And an obligation, even though intangible, is capable of being collected as appellant, not appellee, has demonstrated in this very case.

Appellee attempts to reconcile its position in this case with the distinction drawn between "levy" and "possession" in Section 67c itself by asserting that "possession" in one part of Section 67c means something different than it does in another. See the discussion in our opening brief at pp. 39-42. Appellee argues that "possession" under clause (2) of Section 67c refers only to cases where actual physical possession is possible. If it is so restricted under clause (2), the concept of "possession" should similarly be restricted in clause (1) of Section 67c, the clause that governs the present appeal.

Appellee itself points out that under clause (2) the word "levy" was added to cover the situation where actual physical possession had not been obtained but only a levy had been made. (Ans. Br. p. 18.) If Congress thought it necessary to add the word "levy" to clause (2) to cover this situation, its failure to insert the same word in clause (1) must mean that a mere levy is not sufficient to meet the test of "possession."[5]

IV. JURISDICTION OF THE BANKRUPTCY COURT.

Appellee asserts that the bankruptcy court had jurisdiction over this controversy. (Ans. Br. p. 18.) With this statement we agree.[6] But we submit that appellee's

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[5]If this difference in the language between clauses (1) and (2) of Section 67c was considered by the Court in *United States v. Eiland*, (CA 4, 1955) 223 F. 2d 118, that fact does not appear in its opinion. We have searched the briefs of counsel for the trustee in that case and cannot find that the point was urged to that Court.

[6]Appellee's filing of its response to the order to show cause put appellee into this proceeding with both feet and completely under the jurisdiction of the bankruptcy court for the purpose of determining its rights to the fund. By its failure to question the sum-

very failure to raise a question of jurisdiction is inconsistent with its claim of "possession." Had the facts here shown that the bankruptcy court was "interfering" with appellee's possession of certain property, appellee would have been the first to question the jurisdiction of the bankruptcy court. *In re Brokol Manufacturing Co.* (CA 3, 1955), 221 F. 2d 640, 642; *Henkin v. United States* (CA 2, 1956), 229 F. 2d 895. Appellee's failure to raise such a defense here shows that appellee itself knew that it had no possession of the claim against Utility Trailer Sales and that its possessory rights were not being interfered with because it had none.

CONCLUSION.

The orders below should be reversed.

Dated, San Francisco, California,
December 10, 1956.

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mary jurisdiction of the bankruptcy court in its response, appellee "shall be deemed to have consented to such jurisdiction". See 2a(7) of the Bankruptcy Act. 11 U.S.C. §11(a)(7), abrogating the rule of *Cline v. Kaplan,* (1944) 323 U.S. 97, 65 S.Ct. 155, to the contrary. See 1955 Supplement to 2 Collier on Bankruptcy (14th ed., 1942, Matthew Bender & Co.) p. 51 (text page 520).